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USDA FOR FAS/FAA/ITP, U/S PENN AND FAS ADMINISTRATOR TERPSTRA
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USDOC FOR 3134/USFCS/OIO/DDEVITO/EOLSON
TREASURY FOR OASIA/SEGAL
PLS PASS TO EXIM FOR A FOLEY
PLS PASS TO USTR FOR SCRININ, LYANG, BPECK

SENSITIVE

E.O. 12958: N/A
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SUBJECT: GRAB BAG OF GOB INDUSTRIAL POLICY MEASURES

Refs: A) Brasilia 1098 B) Brasilia 661

SENSITIVE BUT UNCLASSIFIED; PLEASE PROTECT ACCORDINGLY.

1. (U) Summary: As promised, Minister of Development, Industry and Trade (MDIC) Luis Furlan unveiled a huge composite of measures under the umbrella of Industrial, Technology and Foreign Trade Policy (PITCE in the Portuguese acronym) on March 31. A grab bag of recycled programs, financing and tax incentives as well as new councils and government agencies, the PITCE comes with promises to modernize, restructure, and streamline the broken pieces of government that hamper industrial growth. Attractively wrapped in technological innovation, the PITCE offers something for everyone (plus a little extra for the four strategic sectors of semiconductors, software, pharmaceuticals and capital goods) while attempting to appear sufficiently different from the discredited industrial policies of Brazil's past. Fiscal constraints necessarily limit the viability of the various options, but the GoB has already budgeted R\$ 550 million (US\$ 183.3 million) for 2004. Furlan and his deputies insist that PITCE is not static and will be altered when necessary to fit the country's development needs. Their assertion parallels Itamaraty's often-voiced reluctance to commit to any multilateral trade obligations that would limit GoB flexibility in this sphere. End Summary.

Everything But The Kitchen Sink

2. (U) On its web site, MDIC defines over 50 industrial policy measures under the headings of a) industrial modernization, b) foreign markets & competitiveness, c) product, process, and management innovation, d) strategic options for semiconductors, e) software, f) capital goods and g) pharmaceuticals, h) harbingers of the future, i.e. biotech and nanotech i) strengthening small and medium enterprises, j) strengthening the national system of innovation, and k) creating a favorable environment for industrial development. Each listing includes a definition of the measure, a goal and a responsible government entity to lead the effort. With such broad parameters, existing programs are easily folded, or slightly modified to fit, into the PITCE.

3. (U) Under foreign markets and competition, export-promotion publicity campaigns executed by the Ministries of Tourism, Culture and Foreign Relations constitute a specific measure. The program "Brazil Exporter," launched in November 2003 by MDIC and also a PITCE measure, is itself a collection of assistance efforts aimed at getting small businesses to export via training, improvements in product design, and greater access to credit. The PITCE broadens the Brazil Exporter program to include specific measures for Brazilian states underrepresented in the export market as well as a new drawback system that would partially reimburse import duties on goods re-exported or used in manufacture of exported goods. Expanding the application of special computerized customs procedures to include semiconductors, and efforts to reinvigorate the metrology network and certification programs under the supervision on INMETRO (The National Institute of Metrology, Standards and Industrial Quality) for paper, cellulose and furniture industries, exemplify the relatively low-cost PITCE goal of redirecting the efforts of bureaucratic structures to accommodate sectors the GoB believes have greater export potential.

4. (U) Modernizing customs policies and procedures, facilitating the opening and closing of businesses, creating MDIC-led competitiveness forums for biotechnology and franchising, as well as development of a broad extension service designed to assist smaller businesses to export their products, typify the horizontal measures that account for much of the PITCE's efficiency and transparency goals. The plan also calls for installation of foreign trade and investment attraction kiosks within the international branches of the Bank

of Brazil, as well as the creation of five distribution and logistics centers overseas to support the efforts of small and medium-sized export businesses.

15. (U) The PICTE spawns more policymaking, calling for the development of specific industrial-policy programs for nanotechnology and biomass. The PICTE prioritizes the passage of several bills including innovation legislation, which would create a legal framework for privately conducted research to be funded through government resources and, in some cases, using government labs. Passage of a bill (1787/96) protecting the intellectual property of lay-out designs of integrated circuits, a TRIPS requirement that has lain dormant in the Brazilian Congress for several years, is now an objective of the Lula administration. Digital inclusion and the free software movement also figure in the policy. Incentives will be designed for the development of software solutions using open code, and the GoB plans to add 30,000 to the network of computer-using small businesses by 2007.

Potentially Affecting the Bottom Line

16. (U) At least eight of the PITCE measures are concrete tax or concessional financing incentives, the most broad being the "Modernaq" program which offers fixed-rate 5-year financing for up to 90 percent of the sale price of industrial-equipment purchases. In addition to Modernaq, the PICTE includes a reduction of the import tax on some capital goods without locally or Mercosul-produced equivalents. (Note: Brazil grants case-by-case reduced tariff rates on specialized capital goods not produced locally.) This reduction of the exceptional tariff rates from 4 to 2 percent for goods produced within Mercosul and to zero for goods not produced within Mercosul began with the implementation of a resolution in February 2004. The GoB characterizes the equalization of the COFINS (social security system contribution) tax on imports and exports (reftel A) and the gradual elimination (starting with a 30 percent rate reduction in 2004) of the industrial production tax (IPI) on equipment destined for productive activity as PICTE measures as well. A Presidential decree (no. 4,928/03) of December 2003 permits reductions in the calculation of the net profit taxes (CSLL) for businesses that invest in technological research and product development.

17. (U) The meat of the benefits for the four strategic sectors are Brazilian Development Bank (BNDES) lines of credit for software marketing and export; pharmaceutical production, research activities, business incorporation, acquisition and fusion; and the purchase or production of made-to-order capital goods. The line of credit for semiconductor production will come from the Ministry of Science and Technology's (MCT) FINEP, the Ministry's financing arm for studies and projects linked to sector specific funds. 2004 financing under these credit schemes ranges from R\$ 10 million for chips to R\$500 million for pharmaceuticals and capital goods.

More or Less Bureaucracy?

18. (U) The PICTE calls for the creation of a National Council of Industrial Development as well as a Brazilian Agency for Industrial Development. While both are to be organized by MCT and MDIC, the Council would bring together government, business and labor to help define policy directives, and the Agency would concentrate the execution of policy objectives in one government organ. In addition, the PICTE envisions a one-stop-shop for potential investors that would also develop the agenda for sector-specific investments. Called the "Special Room for Attracting Investment," this permanent group directly linked to the Presidency would bring together representatives of the Ministries of Development, Foreign Relations, Finance, Planning, Mines and Energy, Agriculture, Science and Technology, Tourism, and the Civil Household.

Government-run Labs

19. (U) Several PICTE objectives aim to create new public laboratories, and to modernize existing ones. While several are specific to the pharmaceutical sector, including a new national factory for the production of blood tests and vaccines and a laboratory for nuclear medicine research and production, others would focus on metrology and biotechnology. A planned national public laboratory for chemical metrology would establish a certification framework to judge the purity of chemical products, and a national laboratory for material metrology would set national standards for building materials such as ceramics and carbon fiber products. The National Laboratory of Industrial Technology will develop projects and promote research in applied micro and nanotechnology in partnership with businesses and the function of the Biotechnology Center of the Amazon, inaugurated in 2002, will be strengthened to better assist businesses with sustainable harvesting of biotech production for commercial purposes. The policy recognizes that bringing successful innovations to

market will require strong intellectual property protection, especially in the target areas of pharmaceuticals, software, nanotech, and biotech. Therefore, the restructuring of the Brazilian Patent Institute (INPI) and improving the regulation of ANVISA, the Brazilian Sanitary Surveillance Agency, are key PICTE measures that require further elaboration (septel).

Comment

10. (SBU) The PICTE is nothing if not ambitious in scope, and it endeavors to encompass parts of the GoB's total development agenda, even social priorities in health and education through digital inclusion and expanding production at public labs. Inclusive, modern, nationalist, populist, this policy offers something to every constituent. By promoting industrial growth and efficiency via incentives to invest in new technology and export, particularly high-value added goods and services, the real prize the Lula administration seeks is job growth. Fostering cutting-edge technological development in the innovative sectors of the future and correcting bureaucratic bottlenecks is the icing on the cake that appeals more to the business than labor crowd.

11. (SBU) Above all, the set of measures which Lula's GoB is cumulatively presenting as its industrial policy is manifestly crafted to avoid significant new budget outlays or adverse policy impact. The designers of the PICTE creatively aim to accomplish its specific goals with minimal fiscal distress, chiefly by re-modeling existing structures and supplementing the energy of the private sector. While there are some clear import-substitution goals, especially in pharmaceuticals, petroleum and gas production, the plan introduces no overtly protectionist quotas or tariff hikes. Those measures that require substantial public investment like the creation of new public laboratories may necessarily be longer-term goals, despite Brazil's world-class research capabilities, due to the tight fiscal environment. MDIC's Secretary for Production, Carlos Gastaldoni has frankly characterized the PICTE to us as part standard operating procedure and part wish list. He considered the Modernag program as the most significant in short-term impact, characterizing the access to capital at a fixed rate as one of the biggest hurdles small Brazilian businesses face. He noted that the strong emphasis on technological innovation should help guarantee a dynamic policy that can respond to industry's evolving needs.

12. (SBU) The GoB's industrial-policy ideology has a trade-policy dimension. Lula's administration considers its freedom to intervene with government supports as potentially essential for Brazil's industrial progress. Any proposal - presented in the context of free trade or not -- that might hem in this ability is rebuffed as an effort to deny an indispensable right, a right that, GoB interlocutors often remind us, more developed economies have freely exercised in the past. Brazilian recognition that the positives and negatives of globalization have significantly altered governments' toolkit of viable options plainly influenced this leftist GoB's supposedly improved version of national 'industrial policy.' The result aims to be a hybrid applicable to Brazil's local realities, but also compatible with existing trade commitments. In practice, its impact in the internal sphere is likely to remain muted. There is far too little in GoB coffers to significantly subsidize chosen industries and too much reliance on trade earnings for this GoB to repeat wholesale the statist policy errors of the nation's 1950s'-1970s' past. For current and future trade negotiations, however, industrial policy goals will continue to limit what the GoB views as in its interest for further liberalization in sectors such as services, government procurement, investment and IPR.

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